Q4 2017 Momentive Performance Materials Earnings Conference Call
February 8, 2018

Corporate Speakers

- John Kompa; MPM Holdings Inc.; VP of IR & Public Affairs
- Jack Boss; MPM Holdings Inc.; CEO, President & Director
- Erick Asmussen; MPM Holdings Inc.; SVP & CFO

Participants

- Nathan Schubert; JP Morgan; Analyst
- Roger Smith; Bank of America Merrill Lynch; Analyst
- Alex Kayvanfar; Redwood Capital Management; Analyst

PRESENTATION

Operator^ Good day, ladies and gentlemen, and welcome to the Fourth Quarter 2017 Momentive Performance Materials Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded.

I would now like to introduce your host for today's conference, Mr. John Kompa, Investor Relations for Momentive. Please go ahead, sir.

John Kompa^ Thank you, Christy. Good morning, and welcome to Momentive's Fourth Quarter and Fiscal Year 2017 Earnings Conference Call. Leading today's call will be Jack Boss, Chief Executive Officer and President; Erick Asmussen, Senior Vice President and Chief Financial Officer; and John Moran, Senior Vice President and General Counsel.

As a reminder, this call is also being webcast and the slides referenced in today's conference call are available through the momentive.com website under the Investor Relations section. A replay of this call will be available by telephone for one week and the replay dial-in information is contained in our latest earnings release. A replay of this call will also be posted on our website.

Before we start, I'd like to read information about forward-looking statements and the use of non-GAAP information as part of this call highlighted on Page 2.

As you know, some of our comments today may include statements about our expectations for the future. Those expectations are subject to known and unknown risk, uncertainties and other factors that may cause that company's actual results and performance to be materially different from any future results or performance suggested by these expectations.

The slide you now see gives you more information on the assumptions and factors we consider in making those forward-looking statements. We can't guarantee the accuracy of any forecasts or estimates, and we undertake no obligation to update any forward-looking statements during the quarter, except as otherwise required by law.

For more information on our risk factors, please see our earnings press release and our SEC filings. In addition, some of our comments may reference non-GAAP financial measures including EBITDA. The most directly comparable GAAP measures are set forth in our presentation and reconciliations to such GAAP financial measures and other associated disclosures are contained in our earnings release and on our website. Please note, our results are preliminary and unaudited and that final audited financials will be included in our annual report on Form 10-K. Our earnings release and our SEC filings are available on the internet at momentive.com.

With that, I'll now turn the call over to Jack Boss to discuss our latest results.

Jack Boss^ Well, thank you, John, and good morning, everyone. 2017 was a strong year for our company and reflects the hard work and commitment of the Momentive team around the world. We continued to significantly grow earnings, invest in new products and our global manufacturing network, strengthen our customer relationships and deliver against our strategic priorities.

Let me mention just a few of the factors that drove our 2017 results and more importantly, positions Momentive for long-term growth and continued margin expansion. First, we continue to generate strong earnings momentum by executing against our strategic plan and drove revenue growth of 10% and 4% respectively for the quarter and full year. We continue to implement our strategy of accelerating profitable growth and transforming our global operations. Segment EBITDA increased 28% and 23% respectively for the quarter and full year. Our margins also rose by 190 basis points for the year and our fourth quarter EBITDA margins were 13.9%.

We continue to focus our investments on the markets and businesses where we have leadership positions. Leveraging our strong intellectual property, we've recently introduced a number of new products including InvisiSil optical bonding for next generation displays, GE-branded roof coating systems and PurQ pharmaceutical packaging designs within our Quartz business, just to name a few.

We've invested $73 million in growth and productivity projects in 2017 and approximately $120 million over the last two years. These growth investments are largely complete and we expect that they will drive significant earnings growth in 2018 and beyond. Our new product pipeline remains full as do our opportunities to make additional strategic investments.

In 2017, we also successfully completed the acquisition of the assets of Sea Lion Technology which produces NXT silanes, one of our key growth platforms.

Next, we enhanced our global manufacturing footprint and drove operational improvements throughout our network. For example, our strategic emulsifications investments in India, Latin America and China position us well to serve our customers in these high growth regions. We also invested in structural productivity as evidenced by our strategic actions at our Leverkusen Germany facility. Our strong 2017 results continue to validate our strategic plan and reflect two consecutive years of significant year-over-year segment EBITDA gains and margin improvement.

Turning to Slide 5, we'll review our fourth quarter 2017 financial results. For the fourth quarter, we drove double-digit sales gains of 10% versus prior year reflecting gains across the entire specialty portfolio. In the fourth quarter, segment EBITDA grew to $83 million or a 28% increase year-over-year, driven by improved mix in formulated and basic silicones, operating leverage in Quartz Technologies and pricing in our basics business as a result of strong global demand partially offset by higher raw material cost.

Our fourth quarter segment EBITDA margin of 13.9% increased by 190 basis points. I'm also pleased to report that we started commissioning our NXT silane expansion in Leverkusen, Germany in this current quarter. This investment, along with the 2017 acquisition of the assets of Sea Lion Technology in Texas City, Texas, positions us well to serve our global automotive customers. As we look ahead to 2018, our outlook is positive and our order book is robust across all business units.

Turning to Slide 6 and our full-year 2017 financial results, we posted strong overall sales growth of 4% led by significant gains in our specialty portfolio offset by strategic reductions in our basic product sales.

Segment EBITDA for the full year increased 23% year-over-year, reflecting higher sales and continued margin expansion within our formulated and basic silicone segment as well as operating leverage and higher sales in our Quartz business. These gains reflect the successful execution of our strategy of accelerating profitable growth by focusing on our high-end specialties and transforming our global operations by taking out structural cost and improving manufacturing efficiencies.

In addition to the year-over-year growth, we saw broad-based gains across the entire specialty chemical portfolio supporting our higher EBITDA margins that increased 190 basis points to 12.6% and we exited the fourth quarter at 13.9%.

Our outlook for the business continues to be very positive and our significant growth investments over the last two years are on track to deliver. We expect to see the positive earnings impact from these investments in 2018 and beyond. In addition, we raised prices across our entire specialty silicones portfolio at the end of the year. While these pricing actions did not have a material impact on our 2017 results, we expect that they will be realized in 2018, which will support further margin expansion.

Now turning to our segments, Slide 7, presents our quarterly performance additives segment results. We drove sales and volume growth across our portfolio driven by positive demand in consumer, automotive, and personal care end markets. Sales increased 9% in the quarter and 6% for the full year.

Full-year performance additives segment EBITDA totaled $188 million or an increase of 1% versus the prior year reflecting the one-time impact of hurricane Harvey and the temporary lead lag impact from raw material inflation that is being addressed by our pricing actions.

We announced pricing actions in the fourth quarter throughout our performance additives portfolio which will positively impact margins starting in 2018. Looking ahead, our order book is strong along all business units, further supporting EBITDA growth and margin expansion in 2018.

Now, turning to our formulated and basic silicone segment on Slide 8, this segment is gaining traction on growth and margin improvement initiatives both. This segment contains both very high-end specialty products such as our coatings, liquid silicone rubber and electronics businesses as well as our basic silicone products. We've strategically focused on driving specialty product sales while intentionally decreasing our basic silicone sales to improve our product mix.

Sales in the fourth quarter were up 11% reflecting strong growth within our specialty portfolio and flat sales in our basics portfolio. Specialties revenue grew 13% year-over-year and our specialties volume growth accounted for approximately 70% of the revenue growth, again, driven by strength in liquid silicone rubber, electronics and consumer products.

EBITDA in the fourth quarter was up 70% or $14 million year-over-year as a result of the volume growth in our specialty portfolio offset by intentional volume decreases in our basics portfolio. This resulting mix improvement along with price increases realized in our basics portfolio were the key drivers of the quarterly EBITDA improvement as well as our EBITDA margin increasing 370 basis points.

Our strong EBITDA performance also reflects the successful transformation of our Leverkusen Germany operations as part of our larger strategic initiative focused on asset optimization and downstream specialties.

Looking at the full-year 2017, revenues were up 1% as a result of strong growth within our specialties portfolio, more than offsetting an intentional reduction in our basic products. Specialties silicones volume growth accounted for approximately 85% of our revenue growth, again, driven by strength in liquid silicones rubber, coatings and consumer businesses.

EBITDA for the full year was up 50% or $35 million year-over-year as a result of the volume growth in our specialty portfolio, the mix shift as we reduced our basics volumes and the benefits of pricing in our basics portfolio as a result of strong global demand in the operating environment for silicones. This had a positive impact on our full-year segment EBITDA margin which improved by 280 basis points. Our outlook remains positive, reflecting our strong order book and supportive industry operating rate dynamics.

Turning to Quartz Technologies segment, on Slide 8, sales increased by 9% in the quarter and 17% for the full year driven by continued strong demand in semiconductor and aerospace markets. Our Quartz Technologies segment EBITDA increased 43% in the quarter and 100% for the full year driven by higher sales, increased operating leverage and improved manufacturing efficiencies. Specifically, we benefitted from increased yields in our quartz production process and our lean and continuous improvement initiatives. Our improved results also reflect the full benefit of our 2016 restructuring initiatives in this segment. The outlook for Quartz Technologies heading into 2018 remains strong, based on our leading technologies and continued strong market dynamics.

Now, turning to Slide 10, I'll provide an overview of our strategic growth capital. Over the past several years, we've strategically invested in numerous high return capital projects to accelerate the growth of our specialty product portfolio and enhance our global manufacturing network. We constantly evaluate the highest and best use of growth capital investments and have a robust allocation framework targeting ROI opportunities exceeding 25%.

Approximately 75% of our growth investments over the past two years are completed and ramping up production. Our positive outlook for 2018 and beyond also reflects our growth capital deployment which today is contributing less than 10% of our current run rate EBITDA levels. These investments should provide significant near-term earnings upside. For example, our flagship NXT investment is being commissioned and will ramp up production in the first half of 2018. NXT is a leading additive for green tire applications.

On the right-hand side of the slide, we've highlighted our multiyear capital investments. We continue to invest in growth areas where we have strategic advantage and the slide highlights a few of our key growth projects. These are investments where we have differentiated technology, leading market positions and are typically invested with and alongside key customers who are also leaders in their respective industries.

We also have investments such as PurQ where we have industry breakthrough products leveraging our core technologies that are aligned with key customers and industry megatrends.

We've invested $73 million in growth and productivity projects in 2017 and approximately $120 million over the last two years. These growth investments are now largely complete and we expect that they will drive significant earnings growth in 2018 and beyond.

Now, I'll turn the call to Erick to give you an update on our balance sheet.

Erick Asmussen^ Thanks, Jack. We continue to maintain a strong balance sheet with significant liquidity. During 2017, we have steadily de-levered and we closed the quarter and the year with net debt to EBITDA ratio of four times. At the end of the fourth quarter, we had cash plus borrowing availability of $387 million compared to $358 million at the end of the third quarter and we also have no significant debt maturities until 2021.

We remain focused on driving free cash flow and maintaining significant financial flexibility while we drive our growth investments and execute on our strategies.

Now, let me turn the call back over to Jack to close.

Jack Boss^ Thanks, Erick. In summary, we are pleased with our continued strong financial and operational performance, which drove fourth quarter top-line gains of 10%, segment EBITDA increases of 28%, and significant margin expansion. We've deployed significant growth capital and these investments are poised to deliver strong earnings growth in the coming years.

With net leverage as low as it's ever been and liquidity of $387 million, we continue to prudently manage our strong balance sheet and deleverage over time. We remain focused on executing our strategy of accelerating profitable growth and transforming our global operations through our multi-pronged strategy of specialties growth and structural productivity programs.

In closing, our strategy is working and our positive 2018 outlook is driven by continued strong demand, solid and improving industry fundamentals and upside from our key growth programs.

John Kompa^ Thanks, Jack. Operator, we'd now like to open the line for questions. If you could please remind callers about instructions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from the line of Nathan Schubert of JP Morgan. Your line is open.

Nathan Schubert^ So my first question is in performance additives. You have volumes increased by 4% year-over-year in 3Q and then 11% in 4Q. With the labor [queues] in ramp, how should we think about volumes in 2018?

Jack Boss^ Yes, in 2018, we'll see performance additives volumes improve and go up. We'll see price improvement go up and we shall see an improvement in mix as well. So we expect NXT to be a big contributor to that, but across the entire portfolio, we should see volumes up as well.

Nathan Schubert^ So just kind of to drill down a little further, should we see it more in line with what we saw in 4Q or more 3Q or somewhere in the middle? I mean I guess just kind of trying to put, you know, kind of benchmark where I should be thinking about volume.

Jack Boss^ Yes, we expect Q3 and Q4, now we saw a good volume growth across our additives portfolio. The NXT will ramp in the first half of the year, so we won't see significant ramp-in in the first half and we have sufficient capacity of our Texas City plant to supply demand in the first half. It's really NXT is going to have a big impact on the back half of the year. So the first half you're going to see mostly the impact of price and volume increases across the balance of the portfolio.

Nathan Schubert^ Okay.

Jack Boss^ NXT really kicking in in the back half of 2018.

Nathan Schubert^ All right, thanks. And then in silicones, 280 basis points margin expansion for the year, that's pretty substantial. I mean I guess how much more can you drive margin expansion via the mix shift and other internal measures versus external factors? I mean how should we think about that?

Jack Boss^ Yes, I think we believe, we've always said that there's a lot of upside opportunity for margin expansion in our formulated and basic segment. I mean as you might -- even the margins were approximately 11% as we exited 2017 and that's really due to the structural cost improvements we've been making in our basics business. We're seeing very strong industry fundamentals now, recent pricing actions and a continued mix up to more specialties in that segment. So frankly, we believe this segment can be mid-teens EBITDA margin in the coming years.

Nathan Schubert^ Great, thank you.

Operator^ Thank you. Our next question is from [Roger Smith] of Bank of America Merrill Lynch. Your line is open.

Roger Smith^ Can you talk about on performance additives, EBITDA flat year-over-year on 9% higher sales, you probably discussed this in your prepared remark, but could you discuss what was going on there?

Jack Boss^ Yes. So we had -- again, you saw a good volume in revenue growth. We had two things affect the business on the EBITDA line in 2017. One was the impact of Hurricane Harvey in our Texas City, Texas plant and more broadly logistically across the effect of the additives business. And then secondly, there was a lead lag on raw material inflation that we were not ahead of in the back half. We've since raised increases across the additives portfolio in the fourth quarter and we expect those margins to rebound in 2018.

Roger Smith^ What was the EBITDA impact of Hurricane Harvey in both of the final two quarters if you have a number?

Jack Boss^ Erick, it's spread over both quarters, Q3 and Q4 as I recall.

Erick Asmussen^ Yes, low single digit millions and it also had an impact to supply chain, so it was more disruption as well as [had] your impacts to Q3 and Q4 frankly declining the earnings in those periods.

Roger Smith^ Okay. And in the basic sub-segment -- the basic sub-segment [out of the] formulated and basic silicones, does that include (inaudible) you still have any merchant siloxane sales or does that include all your siloxanes EBITDA and then you -- you then transferred that internally to both the formulated sub-segment within that segment and then on as well over to the performance additive segment? Is that how that works?

Jack Boss^ Yes, I think -- let me just qualify the question a bit, very little of it goes into the performance additives segment just so you know, that most of performance additives is sort of doesn't connect to the siloxane supply chain. But you're absolutely right on the first two pieces. We both forward in a great siloxane to downstream specialties as well as have a merchant sales, siloxane and siloxane derivatives, all of which are in our formulated and basics performance.

Roger Smith^ Okay, got it. And when you say you've been exiting out of basics, will you be exiting out of merchant siloxanes or do you mean exiting out of some basics silicones and then perhaps pushing the rest of it into merchant siloxanes and selling that?

Jack Boss^ Yes, we're never going to exit through our core capability in manufacturing of siloxane. We have four sites around the globe as you might know, three in Asia and one here in North America. What we've been doing is looking at our portfolio and where we have underperforming product lines and businesses, historically they've been around sort of that basics, their basics plus portfolio. We've been exiting those product lines and frankly focusing all of our investment, all of our time in -- company focus on our specialties portfolio.

So if you were to look at our investment profile, everything that I've talked about was against our specialty portfolio. And you recall, we did the Leverkusen restructuring at the beginning of last year and we're seeing the positive impacts of that as well.

Roger Smith^ Got it. Thank you very much.

Jack Boss^ Thanks, man

Operator^ Thank you. (Operator Instructions) Our next question is from Alex Kayvanfar of Redwood Capital. Your line is open.

Alex Kayvanfar^ Hey, thanks for taking the questions. On Quartz, can you just talk about where the order book stands coming into 2018 versus what you guys saw coming in 2017?

Jack Boss^ Yes, Quartz business continues to be very strong and we've actually believed that we've established a new base in the Quartz business and we expect that it will continue to grow. We're seeing continued strong demand in the semiconductor space and we're also improving operations in the business.

So very bullish in the Quartz business, our plants are running well. You might know we also introduced a new product called PurQ in that segment for pharmaceutical packaging application, but in our core semiconductor demand and aerospace demand, is still very strong.

Alex Kayvanfar^ Got it, okay, great. And then in silicones, I don't know if you can talk to this at all, but what capacity of utilization is your system running at?

Jack Boss^ Yes, we don't give specific operating rates for our sites, but I can tell you that the industry dynamics have improved dramatically and we've seen this increase over the past sort of 12 to 18 months. We haven't seen any meaningful capacity come online, yet demand continues to be very strong globally. So we're seeing continued tightness in the markets and the outlook for silicones, siloxanes and silicones in general remains very strong.

Operator^ Thank you. And that concludes our Q&A session for today. I'd like to turn our call back over to Mr. Jack Boss, CEO of Momentive for any further remarks.

Jack Boss^ Thanks, operator, and thanks for joining our call today after a strong 2017. We're enthusiastic about 2018 and we look forward to updating you on our next earnings call.

Operator^ Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program and you may all disconnect. Everyone, have a great day.